



C&V

Consulting

EDIP: Rebuilding European Defence by Strengthening our Industry (1/2)

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Executive Summary

Main Argument

Strengthening the European Defence Technological and Industrial Base (**EDTIB**) **in the short and medium term is an imperative to reinforce the deterrence and defence** capabilities of Member States. This will enable Member States and the EU to take greater responsibility for their security and contribute more effectively to collective transatlantic defence within NATO.

With EDIRPA and EDIP, the policy debate on how to strengthen the EDTIB has focused on the common procurement of defence products. However, it is **often neglected that the way in which common procurement is done matters as much as the act itself**. Indeed, current EU initiatives such as EDIRPA do not entirely address this issue. That should not be the case for EDIP. Additionally, EDIP has the potential to be **more ambitious than just common procurement**.

To address this, C&V Consulting proposes a vision for EDIP that draws from the experience and **lessons learned from the European Defence Fund (EDF)** and expands the scope of EDIP **from simple common procurement to common acquisitions**.

This paper proposes **four key principles - and associated recommendations** - aimed at maximising EDIP's impact in strengthening the EDTIB:

1. EDIP should contribute directly to the EU's **strategic autonomy**;
2. Suppliers across the EU should be able to participate in a **level-playing-field**;
3. EDIP must provide **strong financial incentives** and use them strategically;
4. More comprehensive and coherent defence capability and industrial **coordination**

Context

In the past decades, **European states underinvested in their defence capabilities and industry**. Europe's fragmented and underdeveloped defence industry, with the associated duplications and interoperability problems, has made it prohibitively expensive for European States to develop and procure technologically advanced capabilities. The situation also made it extremely difficult for European defence companies to respond in a satisfactory manner to sudden and sharp increases in demand, as currently witnessed following the invasion of Ukraine.

In response to the Russian aggression, many Member States quickly moved to support Ukraine's war effort and enhance their own conventional deterrence posture. However, most of the acquisitions and orders placed by Member States occurred through **unilateral, uncoordinated, and off-the-shelf purchases from third countries** (the US, Turkey, Israel, South Korea, etc.).

Engaged in a vicious cycle, a fragmented and underdeveloped European industry perpetuates Member States' **dependency on third countries** for the supply of defence equipment, but, in turn, this **further weakens the EDTIB**.

In the *Joint Communication on the Defence Investment Gaps Analysis and Way Forward* of the 18 of May of 2022, the Commission put forward two major initiatives aimed at strengthening the EDTIB through common procurement: The European Defence Industry Reinforcement through Common Procurement Act (EDIRPA), and the European Defence Investment Programme (EDIP).

EDIRPA is a modest, short-term instrument with the dual objective of strengthening the EDTIB and helping Member States replenish their stocks of the most urgent defence products. **Post 2024, EDIRPA will be replaced by EDIP, which is meant to be a more ambitious and permanent**.

This paper is the first part of a duology on the European Defence Investment Programme (EDIP):

(1) EDIP: Rebuilding European Defence by Strengthening our Industry synthesizes the main ideas that C&V Consulting proposes for EDIP, their rationales and the recommendations that emanate from these ideas.

(2) A Practical Vision for EDIP is the second part of the duology. The paper proposes a concrete description of how all the ideas presented in the first part can be articulated, in practice, into a coherent whole.

The Values of C&V Consulting

C&V Consulting is strongly committed to the strengthening and ethical development of the EDTIB. Strengthening the EDTIB is necessary to reinforce the deterrence and defence capabilities of Member States. A consolidated and competitive EDTIB will enable Member States and the EU to take greater responsibility for their security and contribute more effectively to collective defence within NATO.

C&V Consulting believes that EDIP is a great opportunity to advance in this regard. That is why we have written this paper proposing four key principles (and their ensuing recommendations) that we believe should uphold EDIP. We do this in the hope of contributing to the public policy debate.

All in all, the final output of EDIP should be a more competitive EDTIB, capable of developing, producing, maintaining and upgrading defence capabilities within the EU's territory. The EDTIB should be capable of doing so on a sufficient scale to sustain a high-intensity engagement, at lower costs and lead times, while also being free of restrictions from non-associated third countries. All of this should occur within the framework of a consolidated EU market, where suppliers from all across the EU could enjoy a proper level-playing field.

Summary of Key Principles and Recommendations for EDIP

EDIP should address both common procurement of defence products as well as the ways in which common procurement is done. To do this, EDIP should build on the experience and lessons learned from the European Defence Fund (EDF). Additionally, EDIP should be more ambitious than simple common procurement and expand its scope to common acquisitions: That means that, in addition to procurement, EDIP should integrate aspects related to capability development (notably in relation with the EDF) and production (access to finance).

With these goals in mind, this paper proposes four key principles - and associated recommendations - aimed at maximising EDIP's impact in strengthening the EDTIB:

1. EDIP should contribute directly to the EU's strategic autonomy

a. EDIP should embrace the 'EDF Blueprint':

- EDIP should allow Member States to launch common acquisition projects for both off-the-shelf defence products and products in the latest stages of development (TRL 7-9), notably in the framework of the EDF;
- EDIP should only allow the acquisition of defence products originating in Member States or associated countries, without inputs from non-associated third-countries;
- A transition period allowing some inputs from non-associated third countries could apply in the first couple of years of EDIP's implementation;
- EDIP should only allow the procurement of defence products free of restrictions by non-associated third countries to use, upgrade or transfer said products;
- Suppliers based in the EU but controlled by non-associated third countries should be allowed to participate in common acquisition projects upon providing strong guarantees.

b. EDIP can facilitate the access to public and private finance.

- EDIP can be a means for political communication vis-à-vis financial institutions (ESG criteria) to facilitate access to private finance by the EDTIB;
- Member States should amend the lending policy of the EIB to allow investments in defence-related projects;
- EDIP can be a framework to channel public funding into and leverage private investments for the EDTIB.

2. Suppliers across the EU should be able to participate in a more level-playing-field

- a. EDIP should promote the organization of genuinely competitive tenders and/or the extension of supply chains across the Union.
- b. EDIP should promote the participation of suppliers across the EU in common acquisition projects, independent of their size and whether the Member State in which they are based participates in the acquisition or not.

3. EDIP must provide strong financial incentives as use them strategically

- a. EDIP must provide strong financial incentives to help create a first proto-market for EU defence products.
- b. The incentives under EDIP should focus on the procurement stage of acquisitions.
- c. In addition to the VAT-exemption, the incentive from the EU budget must be strong enough to overcome the 'juste-retour' bias of Member States.
- d. The incentive from the EU budget can propose a bonus system and award criteria that incentivize the characteristics of common procurement most likely to reinforce the EDTIB.
- e. The financial incentives should be considered from the industrial perspective, and the work programme of the incentive from the EU budget should follow capability planning criteria.

4. There needs to be more comprehensive and coherent defence capability and industrial coordination

- a. Establishing an EU Joint Defence Programming and Acquisitions Function:
 - The Function should ensure joint comprehensive multiannual capability programming;
 - The Function should help ensure the coordination between EU instruments, NATO's framework and the capability needs and planning processes of Member States;
 - The Function should involve national Joint Chiefs of Staff to facilitate the harmonization of capability specifications and speed up the adaptation of national capability processes to EU defence industrial instruments;
 - The Function could take form within the EDA, which could also act as single common acquisition platform under EDIP.
- b. Defining EU Defence Technological and Industrial Baseline Objectives:
 - The document should ensure the coherence between of EU and Member State initiatives and that these initiatives systematically contribute to the strengthening of the EDTIB and the EU's strategic autonomy;
 - The document should map out the technologies and production means essential for the EU's strategic autonomy;
 - The document can be used as a guide for the coordination and elaboration of the award criteria of multiple EU initiatives: EDF, the financial incentive of EDIP, Horizon Europe, etc.

Four Key Principles for EDIP

The policy debate on how to strengthen the EDTIB has been focusing on common procurement. Indeed, common procurement can be a powerful means to reinforce the EDTIB. However, **the way in which common procurement is done matters as much as common procurement itself**. If common procurement is limited to replicating the usual practices of individual Member States in a slightly more coordinated manner, common procurement actions will have a very limited impact in strengthening the EDTIB. Nonetheless, current EU initiatives such as EDIRPA do not entirely address this issue. That should not be the case for EDIP.

To address both common procurement and the ways in which common procurement is done, EDIP should **build on the experience and lessons learned from the European Defence Fund (EDF)**. Indeed, the EDF¹ is, to date, the most **ambitious and game-changing** EU program for the EDTIB. For the first time, the EU mobilised its own budget, under supranational control, to deliberately improve the **competitiveness of the EDTIB**. New rules and procedures ensured that the EU budget was dedicated to both strengthening the competitiveness of **EU-based defence companies** and the development of solutions meeting the needs of the European armed forces. Additionally, the EDF allowed defence companies of all sizes and nature across the EU to participate in the programme in a **more level-playing-field**.

According to the *Joint Communication*, EDIP will create an EU framework for Defence Common Procurement, and it will be composed of three elements: The European Defence Capability Consortia (EDCC), a VAT exemption for commonly procured defence products, and a financial incentive from the EU's own budget².

Although, this paper welcomes the initiative, it believes that **EDIP should be more ambitious** and expand its current scope to cover **common acquisitions**. EDIP should not only address the issue of **common procurement**, but also integrate the aspects related to capability **development** (notably in relation with the EDF) and **production** (access to finance)³. Additionally, EDIP should also position itself as in the centre of a wider effort to **improve coordination and planning for the capability and industrial domains at the EU level**.

To promote an ambitious EDIP and based on the experience and lessons learned from the EDF, C&V Consulting proposes that EDIP be based on the 4 key principles:

A) Principle #1 - EDIP should contribute directly to the EU's strategic autonomy

The underlying point of strengthening the EDTIB is to reduce the EU and Member States' strategic dependencies, thus enabling them to take greater responsibility for their own security. This entails the **ability to develop, produce, maintain and upgrade defence capabilities within the EU's territory**. The EDTIB should be able of doing so **on a sufficient scale** to sustain a high-intensity engagement, at lower costs and lead times, and to do so while being free of restrictions (use, export) from non-associated third countries. To achieve this, EDIP should embrace the **'EDF Blueprint'** and **facilitate the access to public and private finance by the EDTIB**.

¹ And its predecessor, the European Defence Industrial Development Programme (EDIDP).

² *Joint Communication on the Defence Investment Gaps Analysis and Way Forward* of the 18 of May of 2022.

³ Indeed, "procurement" refers only to the "off-the-shelf" purchase of a final product. "Acquisition", on the other hand, also includes other dimensions of ownership, such as harmonization of specifications, capability development, and production. In that sense, procurement merely constitutes the final stage of a much broader acquisition process.

a. The "EDF Blueprint" for an ambitious EDIP

At the core of EDIP will lay the new legal figure of "**European Defence Capability Consortia**" (**EDCC**). The EDCC would be the framework within which Member States would cooperate to procure defence products off-the-shelf, coordinate the development of defence capabilities, and acquire the capabilities that they jointly develop; as well as apply for EDIP's incentives⁴. This is why **the EDCC, and its regulation, are central to any proposal for EDIP.**

In order to expand the scope of EDIP from simple common procurement to common acquisitions, it is important that Member States be able to launch common acquisition projects for defence products still in development. In C&V Consulting's vision for EDIP, Member States should be able to launch an EDCC to **commonly acquire defence products in the latest stages of development (TRL 7-9), notably in the framework of the EDF.** This would ensure coherence between joint capability development (EDF) and the common procurement of the developed capabilities (EDIP).

For more details on the EDCC and the proposed set up of EDIP, please consult Section I of the second part of the duology, A Practical Vision of EDIP.

Nonetheless, the creation of an EDCC should be based on **criteria aimed at reinforcing the EDTIB.** For the sake of coherence and efficiency, these criteria should capitalise on those already set out in "**the EDF Blueprint.**"⁵

The practice of almost systematically procuring off-the-shelf products from non-associated countries runs directly against the logic of reinforcing the EDTIB, and it drastically reduces the incentives for EU defence companies to invest in their own industrial capacities and internal R&D.

Thus, and abiding by EDIP's legal base (Art. 173 of TFEU), EDIP should, in principle, only allow for the common acquisition of **defence products originating from Member States and associated countries.**

In order to account for the current dependencies of the EDTIB and to allow suppliers from all Member States to participate in common acquisition projects, EDIP could provide a certain degree of flexibility during the first couple of years of its implementation. Following that transitional phase, EDIP would progressively require ever lower levels of non-associated third-country inputs; collectively pushing the EDTIB towards more integral strategic autonomy.

Additionally, it is particularly important that EDIP exclusively allows the common procurement of defence products **free of restrictions by non-associated third countries to use, upgrade or transfer the associated products.**

In order to transition from a "reactive" to a more "proactive" approach, when a defence product earmarked for common procurement is subject to restrictions, developing a restrictions-free EU alternative should become a priority. The development of this alternative could be done within the framework of the work program of the European Defence Fund.

Finally, suppliers based in the EU but controlled by non-associated third country or non-associated country entities should only be allowed to participate in common acquisition projects under EDIP, conditional on the provision of **strict guarantees.** These guarantees should ensure that foreign control exercised over these companies do neither compromise sensitive information nor their ability to carry out the action of the project.

⁴ To better understand how C&V Consulting proposes EDIP to work in practice, please refer to Illustration 1 on page 10.

⁵ The 'EDF Blueprint' is the Commission's parlance referring to the overall eligibility and award criteria of the EDF.

It should be noted that these restrictions are without prejudice of Member States' sovereign freedom to acquire or procure products they need outside of the very specific scope of EDIP.

b. Facilitating access to finance

EDIP and the legal figure of the EDCC could act as a means to **facilitate access to both public and private finance** for EDTIB stakeholders. In a context of both increasing demand and operational urgency, strengthening the EDTIB and scaling up Europe's production capacity needs significant investments. Access to finance is important for all defence companies in general, but particularly critical for SMEs and MidCaps.

Firstly, the EDCC could constitute a powerful vehicle for **political communication** vis-à-vis finance institutions. It would serve as a to convey an explicit message with regards to **ESG criteria**: Investing in defence within the scope of EDIP or an EDCC contributes to the strategic autonomy of the EU and, therefore, meets the objectives set out in the "social" pillar of ESG.

Amending the lending policy of the European Investment Bank (EIB) to enable investments in defence-related projects in the EU would greatly facilitate access to finance for the EDTIB: Private banks and investors will be more willing to invest in defence following the EIB's policy.

Finally, and in parallel, the EDCC could also serve as a framework to **channel public funding and leverage private investment for the EDTIB**: The EU and Member States could use their own public lending bodies and programmes (such as the InvestEU Fund) or existing funds (Next Generation EU or Cohesion) to either directly finance or leverage private investments to ramp up the industrial capacity of the EDTIB.

B) Principle #2 - **Suppliers from across the EU should be able to participate in common acquisition opportunities in a more level-playing field**

For common acquisitions to effectively reinforce the EDTIB, suppliers from across the EU must be able to benefit from opportunities in an open and more level-playing field.

One of the main stakes with EDIP should be overcoming the chronic tendency of Member States to acquire defence products following policies based on the principle of "juste retour". Consequently, **suppliers in the EU should have the opportunity** to participate in common acquisition projects under EDIP, **regardless of their size or whether the Member State in which they are based participates in the acquisition or not.**

This means that, for instance, a supplier from a fourth Member State should have the opportunity of participating in the common acquisition project of three Member States, regardless of the supplier's size and the Member State in which it is based.

This could be achieved by:

- Promoting the organisation of **genuinely competitive tenders**, notably for relatively simple procurement contracts (such as ammunition);
- Ensuring that common acquisition projects embrace a **strong cross-border approach, with the aim of extending supply chains across the Union.**

It should be noted that in the particular context of the defence industry, fostering **competition between suppliers** should hardly constitute an end in itself, but rather **a means to facilitate the participation of suppliers across the EU** and an incentive for the EDTIB to consolidate and obtain the best-value-for-money in the process. However, defence **acquisition projects also constitute a means to develop and maintain the necessary technologies and production tools for the**

future: That is why "best-value-for-money" cannot be the only factor in EDIP. What is clear is that the EDTIB should be reinforced from a pan-EU perspective.

Creating a **more level-playing field** for suppliers to participate in common acquisitions is also likely to **raise political support for EDIP across all Member States**, notably for those with small, specialised and cooperation-prone stakeholders.

C) Principle #3 - EDIP must provide strong financial incentives and use them strategically

Limiting the scope of common acquisition projects under EDIP to suppliers based in the EU and associated countries and enabling these suppliers to compete in a more level playing field would help create a **first proto-market for EU defence products**.

Such a market, although limited in scale, will strongly reinforce the EDTIB, but it will also create losers and winners. For Member States to accept these redistribution effects and the coordination costs associated with common acquisition projects, the EU must offer significant financial incentives to Member States.

The **EDF** already covers defence **research and capability development activities**. That is why under **EDIP**, the EU should propose **incentives only for common procurement**. This approach would prove both efficient and coherent, notably in view of previous and ongoing initiatives at the EU level.

As things currently stand, the proposed **VAT exemption** for commonly procured products reduces the financial costs associated with procurement for the defence budget of Member States, but it does not have an impact on Member States' general budget⁶.

The VAT exemption might be seen as an incentive for the Ministries of Defence, but not for Member States as a whole. That is why, in order to **overcome the "juste retour" bias** and promote the best practices in common procurement, EDIP needs to integrate an additional and **significant financial incentive from the EU's budget**:

- The EU budget could be used to not only **incentivise** common procurement, but also to **incentivise the characteristics of common procurement most likely to reinforce the EDTIB**. To do this, the size of the financial incentive from the EU's budget for give procurement projects could be determined through a **financial bonus system (akin to that of the EDF)** that would reward specific characteristics such as the cross-border nature of the common acquisition project, the involvement of SMEs and MidCaps, etc.;
- The award of the incentive from the EU's budget should be based on **award criteria (also akin to the EDF)**. These award criteria would help the Commission to select those **common acquisition projects** that best respond to the capability needs of Member States and, especially, **best contribute to the development of the EDTIB**⁷.

While the VAT exemption and the incentive from the EU's budget (bonus system and award criteria) should be considered mostly from the industrial perspective, the **Work Programme associated to the incentive from the EU's budget would have to be based on defence capability planning-related criteria**.

⁶ The VAT paid by the Ministry of Defence in the procurement of defence product is collected by the Member State's Ministry of Finance. As such, the VAT exemption positively impacts the Defence budget proves neutral from the perspective of Member State's general budget.

⁷ This implies that, while all EDCC projects could benefit from a VAT-exemption upon entering the procurement phase, not all projects would obtain the incentive from the EU's budget.

The Work Programme should identify and prioritise those capability priorities of Member States that can be commonly acquired under EDIP. This requires more coherence and convergence in national, EU and NATO capability planning.

D) **Principle #4 - There needs to be more comprehensive and coherent defence capability and industrial planning and coordination**

EDIP must be coherent with other EU defence industrial initiatives, NATO's framework, and the capability needs and planning processes of Member States.

Common acquisitions form a complex *continuum*. Member States should, altogether, be able to jointly procure the capabilities they currently need; to jointly develop the capabilities they will need in the future; and go as far as jointly acquire what they jointly develop.

However, capability planning processes are projected 10 to 20 years into the future, and the processes of Member States, NATO and the EU remain far from coordinated. Additionally, the current approach does not allow sufficient prioritisation of capability projects and needs from an EU perspective:

On the capability dimension, there is a need to establish an **EU Joint Defence Programming and Acquisitions Function**. Building on the pre-existing CARD, CDP and PESCO⁸, the function would have to ensure joint comprehensive multiannual programming, as well as the refinement of capability needs and specifications.

This function should collectively involve **Member States, the EDA, and DG DEFIS, with an observer status granted to the EEAS** (including the EU MS), and the **representatives of the national Joint Chiefs of Staff**.

The **involvement of end-users (national Joint Chiefs of Staff)** will prove instrumental to facilitate the **harmonisation of specifications** for capabilities to be jointly developed or commonly acquired, and to **speed up the adaptation of national capability planning processes** to account for parallel EU defence industrial initiatives.

The function could take form within the **EDA, which could also play the role of the single common acquisition platform under EDIP**.

On the defence technological and industrial dimension, there needs to be increased coherence between the EU and Member State initiatives, within and without the Defence field.

The greatly deteriorated security situation and the need to support Ukraine's war effort calls for a ramp up of the manufacturing capacities of the EDTIB in the short and long term. It also calls for a strategic agenda allowing sustaining this ramp-up effort in the longer term, in order to adapt to upcoming geopolitical evolutions.

Defence acquisition projects are also a means to develop and maintain the necessary technologies and production tools for the future. However, to achieve this, these projects and other initiatives need to be done in a strategic way.

The Commission and Member States should agree on **"EU Defence Technological and Industrial Baseline Objectives"** that would help map out the technologies and means of production that are essential for the EU's strategic autonomy (from an EU-level perspective) in the present and the future.

⁸ Coordinated Annual Review on Defence (CARD), Capability Development Plan (CDP), Permanent Structured Cooperation (PESCO).

The resulting comprehensive document would constitute a guide for the elaboration of the **work programme and the award criteria** for the EDF, the financial incentive from the EU's budget under EDIP, the third cluster of Horizon Europe, and other defence industrial activities.

This way, the EU (defence) Industrial initiatives will systematically contribute to achieving these defence technological and industrial baseline objectives **in the most coherent and effective way possible**.

EU Defence Industrial Initiatives Including the Proposals for EDIP

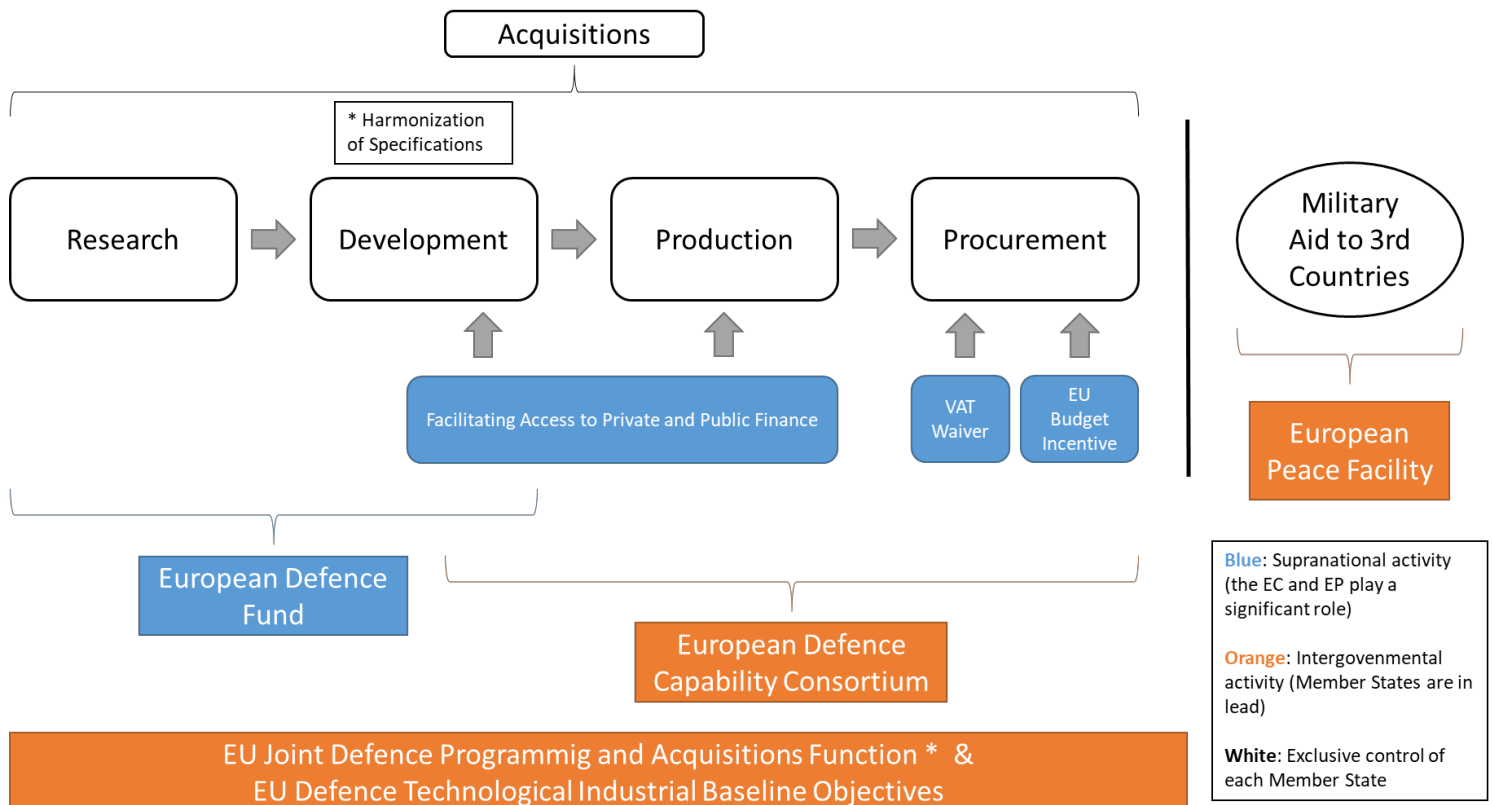


Illustration 1: Outlook of EU Defence Industrial Initiatives Including this Paper's Proposals for EDIP⁹.

⁹ Inspired by Illustration "Le financement de l'industrie de la défense européenne par l'UE" in « L'UE, Sponsor Passif de la Défense Européenne ». Federico Santopito, Groupe de Recherche et d'Information sur la Paix et la Sécurité, 30 of August, 2020.





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